Hearing on
Federal Revenue Options
before the
Committee on the Budget
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Statement of U.S. Representative Max A. Sandlin, Jr.

Mr. Chairman, Ranking Member Spratt, distinguished Members of the Committee, colleagues—current and former—I first want to thank you for affording me the opportunity to appear before the Committee today to address one of the most important issues within the jurisdiction of Congress.

More often than not, the debates on the floor of the House and in the Committee rooms revolve around defending our nation against the threat of terrorism at home and abroad, the education of our children, access to health care for the uninsured, improving health coverage for our nation's seniors, ensuring that our nation's highways and infrastructure are adequately improved and maintained, enhancing the opportunity of our nation's working families, or protecting our environment. All of these are without question noble goals and worthy of debate. However, the common thread running through each and everyone of these issues is the fundamental question: How do we pay for it?

The Constitution confers original authority over this question on this, the People's House, in Article I, Section 7: "All Bills for raising Revenue shall originate in the House of Representatives . . .." Accordingly, it is fitting that we gather today to discuss several options for raising the revenue needed to fulfill our constitutional admonition to "establish Justice, insure domestic Tranquility, provide for the common defence, promote the general Welfare, and secure the Blessings of Liberty" for the American people.

For more than ten years, my friends on the other side of the aisle have made tax reform and simplification a cornerstone of their economic program. Their commitment to this notion is one with which I wholeheartedly agree. Their expertise and understanding of many of these issues is indeed admirable. However, for all their effort, they seem to have fallen far short.

There can be little doubt that taxpaying American citizens and businesses—particularly small businesses—spend far too much time not just preparing their tax returns and paying their taxes, but in even figuring out just how to file, which forms to fill out, what tax preferences they qualify for, what they can deduct, and what elections they should make to best serve their personal needs or the interests of their family, business and employees. The need for simplification is something on which we can all agree.

On top of that is the anxiety that all taxpayers experience when confronting the daunting complexity of the tax code and trying to make sound tax-planning decisions with the prospect of taking a wrong turn in a mind-numbing maze that makes tax lawyers and accountants shudder.

In January 1996, then Speaker Newt Gingrich stated, "The tax code has over the years become increasingly politicized and is seen less as a simple tool for raising revenue than as an instrument for social and economic engineering . . . exponentially increasing the complexity of the code. . . . The current system is indefensible. ... Today's tax code is so complex that many Americans despair that only someone with an advanced degree in rocket science could figure it out. They are wrong. Even a certified genius such as Albert Einstein [would have] needed help in figuring out his Form 1040."

Such complexity is both unnecessary and unhealthy for the taxpayer and our nation's economy. Accordingly, let me be clear. I wholeheartedly support meaningful efforts to reform our tax system to reduce a comparatively extreme burden and to ensure efficiency combined with ease. We need to focus our efforts on reforming our nation's revenue generation in ways that (1) ease the burden on working families and small business, (2) are fiscally responsible and realistic, and (3) provide a foundation for solid economic growth.

Nine years ago, then-Ways & Means Committee Chairman Bill Archer declared his intention to "tear out the income tax by its roots and discard it and replace it with a new form of taxation." Just three years ago, continuing this theme, Majority Leader DeLay derided the "mind-numbing complexity" of the tax code and declared his intention to make the code "fairer, flatter, simpler and less burdensome on the American people."

Again, easing the burden our tax code imposes on working families and small business is a worthwhile goal, and I will gladly join with my colleagues in working toward that end. However, the proposals that have gained the most popularity and attracted the most attention of late are neither realistic nor fair. They may represent a "new form of taxation" and have a "flatter" rate structure, but they are hardly "fairer, simpler . . . [or] less burdensome."

The unquestioned reality is that consumption taxes, such as the national retail sales tax proposed in H.R. 25, are extraordinarily regressive and punitive of the vast majority of working families. Far from providing the much-touted relief, a national retail sales tax would dramatically increase the effective tax rate on at least 60 percent of American working families, while simultaneously dramatically decreasing the effective tax rate on the 20 percent of Americans who earn the most money.

An additional problem arises from the proposal embodied in H.R. 25, because the tax increase imposed on 60 percent of American working families is based on the excessively rosy revenue assumptions of its proponents. The reality of the scope of the tax increase under H.R. 25 is likely far worse. According to the Joint Committee on Taxation, the 23 percent tax-inclusive rate (30 percent tax-exclusive) is not revenue neutral and, in fact, grossly understates the national retail sales tax rate required to maintain current services.

The JCT estimate suggests that the actual rate required to maintain revenue neutrality under the H.R. 25 proposal would exceed 50 percent. Economists agree that the rate proposed in H.R. 25 will have extraordinarily deleterious economic effects on the federal tax burden and household budgets of our nation's working families, many sectors of our business community, and the American economy overall. Despite its proponents' claims, H.R. 25 is anything but pro-family and pro-growth. It amounts to a massive tax increase on a clear majority of Americans.

Under current law, effective tax rates start low and increase as income goes up. Accordingly, at present, the effective federal tax rate on the lowest 20 percent of earners is around five percent, while the top one percent of earners—individuals making in excess of $315,000 annually—have an effective federal tax rate of 25 percent.

By contrast, under H.R. 25 as introduced, at minimum, 60 percent of American workers would experience a federal tax increase—in many cases, a dramatic increase—while the top one percent of earners would see their effective federal tax burden drop to five percent.

When the 60 percent of American workers with the least income would experience a substantial federal tax increase, as they would under H.R. 25, that is hardly the "relief" American taxpayers deserve, and it certainly is not the reform or simplification we should be considering seriously.

When we focus on consumption-based tax systems, particularly as a replacement for a graduated, progressive income tax, we are really asking ourselves "which middle class tax increase do we prefer?" For my part, I believe middle-income working Americans have suffered enough and deserve relief and reform that benefit their household budgets—not so-called "reform" that punishes their hard work, rewards wealth that will be increasingly difficult for working families to obtain, and significantly widens the opportunity gap.

On Monday, in Des Moines, Iowa, President Bush signed bipartisan legislation that continues the tax relief for working families we passed in 2001. I was proud to support that legislation in 2001 and in 2004, because it provides directed and meaningful relief for American taxpayers who very much need it. It extends the $1,000 child tax credit, marriage penalty relief and the expanded 10 percent tax bracket. As a consequence, according to the President, 7 million low-income families will see an increase in their child tax refunds, and "94 million Americans will have a lower tax bill next year, including 70 million women and 38 million families with children."

That's genuine tax relief. That is what we should be doing for the American people.

Yet today we gather to consider tax reform proposals that would deny working families with children their personal exemptions, the child tax credit, the earned income tax credit, and the mortgage interest deduction.

Under current law, a family of four is exempt from the federal income tax until their household income exceeds $40,000. Thanks to the earned income tax credit, a family of four with an income below $25,000 does not even bear the burden of payroll taxes. By contrast, under H.R. 25 as introduced, these lower income working families would experience dramatic and potentially devastating federal tax increases; instead of being virtually exempt from federal tax, these families would see fully 30 percent of their income over $19,000 eaten away by the national retail sales tax. For hard working families such as these, who are already struggling to survive, such a tax increase would push many over the edge and into bankruptcy. America's hard working families deserve much better.

Even working families with moderately higher incomes would see their federal tax burden increase dramatically if H.R. 25 were enacted. A home-owning family of four with a household income of $65,000 and more or less typical expenses and saving patterns would see its federal tax more than double from $4,417 under current law to $9,600 under the proposed national retail sales tax embodied in H.R. 25. A similar family of four with a household income of $130,000 would see its federal tax liability jump more than 50% from around $17,000 under current law to $27,000 under the tax plan proposed by H.R. 25.

Again, there is no doubt that our tax code is riddled with complexity and must be simplified, but there probably is equally no doubt that increasing the federal tax burden on the vast majority of working Americans is absolutely not an appropriate solution to that problem. That is exactly what the national retail sales tax proposed in H.R. 25 would do.

I would call on the Committee to consider just a few of the extraordinarily adverse impacts H.R. 25 would have on the American people and economy.

The national retail sales tax as proposed by Mr. Linder would impose a huge unfunded mandate on state and local government well in excess of $300 billion in the first year alone, because state and local governments would not be exempt from paying the tax proposed by H.R. 25, except with respect to education-related expenditures. Accordingly, every time a state or municipal government buys a new fire truck or improved communications equipment for its law enforcement agencies, they will have to pay a 30 percent federal tax on those purchases. Such increased costs will either lead to the financial ruin of our state and local governments or require significant increases in state and local taxes to make up the difference. In my home state of Texas, enactment of H.R 25 would cost state and local governments $20 billion per year, which, according to one estimate, could require property tax increases of up to 80 percent. Under H.R. 25, "simplification" of our federal tax system would lead to dramatic tax increases at the state and local level. I have every confidence that proponents of the national retail sales tax will have a hard time convincing Texans that H.R. 25 is a good idea.

The passage of H.R. 25 would lead to huge tax increases on our nation's seniors and effectively require them to pay twice for their Social Security and Medicare benefits. Moreover, such consumption taxes would have particularly harsh effects on seniors who live on their lifetime savings, monies on which they have already paid federal taxes, because they will now be required to pay a new, much higher federal tax each time they buy a prescription, see a physician, fill up their car, or go to the grocery store.

H.R. 25 imposes a new 30-percent federal tax on health insurance, health care services, the purchase of new houses, housing rents, and energy, virtually all of which are not presently subject to federal tax. Accordingly, a person's $100 monthly health insurance premium will now be $130. His $1000 monthly rent will now rise to $1300. At current prices, every gallon of gasoline he consumes will go up sixty cents. Moreover, a portion of the interest payments families pay on their mortgages, instead of being allowed as a deduction from their income, will be subject to a new, 30-percent federal tax.

H.R. 25 will deal a double blow to our nation's charitable institutions. First, under current law, they are exempt from federal tax; that exemption is eliminated under H.R. 25, and their costs will increase concomitantly, thereby reducing their ability to serve the communities and missions to which they are dedicated. Second, under current law, Americans have an incentive to contribute to their churches, schools and other charitable agencies: they can deduct those contributions from their income. Under H.R. 25, that incentive is stripped away, a potentially crippling blow to charities that often barely survive as it is.

Automakers and homebuilders will suffer an extreme setback if the national retail sales tax proposed by H.R. 25 becomes the law of the land. Consumers will rethink purchasing new cars when the reality that a $15,000 car they thought they could afford, becomes an out-of-reach $19,500 car after the national retail sales tax is tacked on. Domestic production of new cars will be decimated. Those along the southern and northern borders will be advantaged, however, as they will be able to go to new car dealers in Canada and Mexico and purchase their new cars without being subject to the national retail sales tax.

Moreover, the impact on new home sales will be equally negative; a new $200,000 home will now cost $260,000, which is quite a different proposition for many young families. Add to that the fact that those families, under H.R. 25, will both lose the mortgage interest deduction and pay a new federal tax on their mortgage payments. The effect on our nation's new home market will be dramatic to say the very least—and not in a positive way.

Our nation's farmers will also face an unsustainable situation, which will likely lead to the elimination of one of our nation's most important institutions—the family farm. Under current law, family farmers buy seeds and feed—the factors of farm production—and are able to deduct those expenses for purposes of calculating their annual federal tax bill. In years when nature works against them—crop loss, drought, disease—farmers may account for those losses against future income, which, in good years, serves to reduce their tax liability and make them whole.

Under H.R. 25's national retail sales tax, family farmers face an entirely different reality. They will be forced to pay this new federal consumption tax on every packet of seeds, pound of feed, and bag of fertilizer. The national retail sales tax is an upfront cost for farmers. If it's a good year, then they will have merely dealt with a dramatic tax increase; by contrast, in a bad year, all those costs will be lost with no allowance for prior or future year offsets. In sum, for family farmers who already struggle to make it, H.R. 25 will be a perfect storm that will drive far more into bankruptcy. The traditional family farm is likely unsustainable under H.R. 25's national retail sales tax.

Other sectors of the economy that benefit from tax preferences under current law will also be dealt a serious blow should H.R. 25 become law. Under its national retail sales tax proposal, developers of affordable housing and renewable energy projects, among others, will face a retroactive repeal of the tax credits that provided the incentive for those entrepreneurs to take those business risks.

In sum, H.R. 25 is regressive. It punishes working families in our society with dramatic tax increases. While proposed as a means of tax simplification, the national retail sales tax proposed by H.R. 25 is neither simple nor fair. Moreover, the assumptions underlying it are terribly flawed. Virtually every economist and tax authority agrees that such a national retail sales tax would create extraordinary problems of administration and enforcement. Moreover, while H.R. 25 proposes a tax-inclusive rate of 23 percent (30 percent tax-exclusive), the Joint Committee on Taxation acknowledges that as a gross understatement of the real rate required to maintain revenue neutrality; some estimates set the rate as high as 57 percent. If, as has been demonstrated, the 30 percent rate provided for in H.R. 25 represents a tax increase on at least 60 percent of America's families, then doubling that would be economically devastating and is totally politically untenable. Making matters worse, H.R. 25 allows for no evasion, no avoidance, and no statutory base erosion. It is not rooted in reality.

We need reform. We need fundamental tax reform. However, we do not need more cynical, unworkable, election-year plans that create a world of losers in a redistribution whirlpool without any real gains in economic efficiency or fiscal responsibility. H.R. 25 represents radical reform, but it is reform of the worst kind—reform with virtually no winners and a sea of economic casualties.

Thank you again for the opportunity to testify this morning. I look forward to continuing to work with my colleagues on both sides of the aisle to enact meaningful, workable, pro-growth tax reform and simplification.